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**Core Competency and Risk Assessment: A Strategic Approach to Determine Which  
Commercial Activities Are Appropriate For Competitive Sourcing**  
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## THESIS ABSTRACT

KAREN M. RHONE

The federal government spends more than \$230 billion annually for products and services.<sup>1</sup> Taxpayers pay this expense, and they are entitled to the maximum value for their tax dollars. The first step in securing maximized value is to determine which activities should be performed by government employees and which activities are appropriate for competition.

This paper discusses the competitive sourcing process. It focuses on the first step in this process, which is the distinction between activities that must be performed in-house and activities that are appropriate for competition. As stewards of taxpayers' money, government officials must use an approach that optimizes performance and value. The best approach is a strategic one. By using long-range strategic planning, agencies can ensure they retain the ability to perform core competencies. They can also analyze the potential risks of contracting out a particular activity. The result is a well informed decision on whether an activity is appropriate for competitive sourcing.

This paper begins by describing how the policy of competitive sourcing was established. It begins with a brief history of OMB Circular No. A-76. This history illustrates the longstanding policy of the federal government to rely on the private sector for commercial services. Next, the paper describes the competitive sourcing process under OMB Circular No. A-76. It then addresses the first step in the competitive

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<sup>1</sup> General Accounting Office, *Biobased Products, Improved USDA Management Would Help Agencies Comply With Farm Bill Purchasing Requirements*, Report to Ranking Democratic Member, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate, Rep. No. GAO-04-437(April 2004) available at <http://www.gao.gov/index>.

sourcing process, which is the requirement to prepare inventories of activities performed by government employees.

Next, this paper describes the guidelines federal agencies use to decide which activities are appropriate for private sector performance. These guidelines include defining inherently governmental activities. Then this paper discusses the different approaches agencies use to identify activities for competition. There is a greater emphasis on the Department of Defense's ("DoD") approach since it has the most extensive experience with competitive sourcing. DoD uses strategic sourcing with a core competency approach to ensure that contracting out does not threaten its crucial core missions. Within DoD, the Army found that the core competency distinction was inadequate. A risk analysis was also used to identify the risk of contracting out a function.

Finally, this paper addresses the inadequacy of the inherently governmental distinction. There is no question that inherently governmental activities must be performed by government employees. However, not every commercial activity should be performed by the private sector. This section concludes by recommending a three-step strategic approach to determine which activities are appropriate for competition. First, agencies classify activities as either inherently governmental or commercial. Inherently governmental activities are excluded from competition. Second, agencies identify their core competencies. Core competencies may or may not be excluded from competition. Third, agencies conduct a risk assessment to identify and weigh the specific risks of competitively sourcing a commercial activity.

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## I. INTRODUCTION

The federal government spends more than \$230 billion annually for products and services.<sup>1</sup> Taxpayers pay this expense, and they are entitled to the maximum value for their tax dollars. The first step in securing maximized value is to determine which activities should be performed by government employees and which activities are appropriate for competition.

This paper discusses the competitive sourcing process. It focuses on the first step in this process, which is the distinction between activities that must be performed in-house and activities that are appropriate for competition. As stewards of taxpayers' money, government officials must use an approach that optimizes performance and value. The best approach is a strategic one. By using long-range strategic planning, agencies can ensure they retain the ability to perform core competencies. They can also analyze the potential risks of contracting out a particular activity. The result is a well informed decision on whether an activity is appropriate for competitive sourcing.

This paper begins by describing how the policy of competitive sourcing was established. It begins with a brief history of OMB Circular No. A-76. This history illustrates the longstanding policy of the federal government to rely on the private sector for commercial services. Next, the paper describes the competitive sourcing process under OMB Circular No. A-76. It then addresses the first step in the competitive sourcing process, which is the requirement to prepare inventories of activities performed by government employees.

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<sup>1</sup> General Accounting Office, *Biobased Products, Improved USDA Management Would Help Agencies Comply With Farm Bill Purchasing Requirements*, Report to Ranking Democratic Member, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate, Rep. No. GAO-04-437(April 2004) available at <http://www.gao.gov/index>.

Next, this paper describes the guidelines federal agencies use to decide which activities are appropriate for private sector performance. These guidelines include defining inherently governmental activities. Then this paper discusses the different approaches agencies use to identify activities for competition. There is a greater emphasis on the Department of Defense's ("DoD") approach since it has the most extensive experience with competitive sourcing. DoD uses strategic sourcing with a core competency approach to ensure that contracting out does not threaten its crucial core missions. Within DoD, the Army found that the core competency distinction was inadequate. A risk analysis was also used to identify the risk of contracting out a function.

Finally, this paper addresses the inadequacy of the inherently governmental distinction. There is no question that inherently governmental activities must be performed by government employees. However, not every commercial activity should be performed by the private sector. This section concludes by recommending a three-step strategic approach to determine which activities are appropriate for competition. First, agencies classify activities as either inherently governmental or commercial. Inherently governmental activities are excluded from competition. Second, agencies identify their core competencies. Core competencies may or may not be excluded from competition. Third, agencies conduct a risk assessment to identify and weigh the specific risks of competitively sourcing a commercial activity.

## II. THE POLICY OF COMPETITIVE SOURCING

### A. *Historical Perspective*

The United States government obtains goods and services from the private sector if it is cost effective.<sup>2</sup> This procurement policy grew out of the United State's basic economic system of free enterprise and capitalism. Sellers compete for customers, and prices are determined by supply and demand. An increase in supply tends to reduce the price of a good. When government competes with the private sector as a supplier of commercial goods and services, it is detrimental to the free enterprise system.<sup>3</sup> It stifles growth in private industry by dominating certain markets.<sup>4</sup> It diverts needed technical personnel from private sector employment. It erodes the tax base by securing work that would be performed by tax paying entities. To keep our economic system in balance, government should rely on the private sector for needed commercial goods and services.

This basic procurement policy began to take root as early as 1932. At that time, a special committee of the House of Representatives expressed concern that the federal government was performing activities more appropriately performed by the private sector.<sup>5</sup> In the 1940s, the first

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<sup>2</sup> OMB Circular No. A-76, *Performance of Commercial Activities*, May 29, 2003, available at [http://www.whitehouse.gov/omb/circulars/a076/a76\\_incl\\_tech\\_correction.html](http://www.whitehouse.gov/omb/circulars/a076/a76_incl_tech_correction.html).

<sup>3</sup> John Cibinic, Jr. and Ralph C. Nash, Jr., *Formation of Government Contracts*, Ch. 3, page 327 (3d ed. 1998).

<sup>4</sup> *End Anti-Competitive Monopolies, Costly Duplication and Unfair Government Competition by Increasing Government Reliance on the Private Sector: Hearing Before the Commercial Activities Panel of the General Accounting Office*, 108<sup>th</sup> Cong. (Jun 11, 2001) (statement of John M. Palatiello, Executive Director, Management Association for Private Photogrammetric Surveyors).

<sup>5</sup> H.R. 235, 72d Cong. (1<sup>st</sup> Sess. 1932).

and second Hoover Commissions expressed a similar concern and recommended legislation to prohibit the government from competing with the private sector.<sup>6</sup> In 1955, President Eisenhower's Administration formalized this general policy in the Bureau of the Budget Bulletin No. 55-4. The bulletin stressed that "the Federal Government will not start or carry on any commercial activity to provide a service or product for its own use if such product or service can be procured from private enterprise through ordinary business channels."<sup>7</sup> Exceptions to this policy were permitted only when an agency could clearly demonstrate in a specific case that the use of the private sector was not in the public interest.<sup>8</sup>

The Bureau of the Budget Bulletin No. 55-4 was revised two times<sup>9</sup> before it was converted to the Office of Management and Budget ("OMB") Circular No. A-76, *Policies for Acquiring Commercial or Industrial Services Needed by the Government*, in 1966.<sup>10</sup> Circular A-76 establishes federal policy for determining whether commercial activities should be provided through contract with the private sector, by the use of in-house personnel, or through interservice support agreements with other federal agencies.<sup>11</sup> In 1979, OMB issued a supplemental

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<sup>6</sup> *End Anti-Competitive Monopolies, Costly Duplication and Unfair Government Competition by Increasing Government Reliance on the Private Sector: Hearing Before the Commercial Activities Panel of the General Accounting Office*, *supra* note 4.

<sup>7</sup> Bureau of the Budget Bulletin 55-4 (Jan. 1955) reprinted in *Diebold v. United States*, 947 F.2d 787,799 (6<sup>th</sup> Cir. 1991).

<sup>8</sup> *Id.*

<sup>9</sup> Budget Bulletin 55-4 was revised by No. 57-7 in 1957 and by No. 60-2 in 1960. It is hereinafter referred to as Circular A-76.

<sup>10</sup> This circular is commonly referred to as Circular A-76, or A-76. It has been revised four times: in 1967, 1979, 1983, and 2003.

<sup>11</sup> OMB Circular No. A-76, *supra* note 2.

handbook to Circular A-76, which set out how to conduct cost comparison studies to determine which of the three sources to employ.<sup>12</sup> Together, Circular A-76 and its supplemental handbook established the broad principles, individual definitions and specific directives on the management of commercial activities.

Every Administration since 1955 has endorsed the policy that the government is to rely on private commercial sources for supplies and services.<sup>13</sup> However, over time, government has been asked to provide more and more services. For example, before September 11, 2001, the Department of Homeland Security did not even exist. Today it is the government's third largest agency.<sup>14</sup> The expansion of government caused an increased emphasis on competitive sourcing. However, in the 1980's through 1995, administrative and legislative constraints resulted in a lull in awarding contracts under Circular A-76.<sup>15</sup> Then in 1995, congressional and administrative initiatives placed greater emphasis on competitive sourcing to achieve cost savings and more efficient operations.<sup>16</sup>

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<sup>12</sup> Circular No. A-76 Revised Supplemental Handbook, *Performance of Commercial Activities*, March 1996, available at <http://www.whitehouse.gov/omb/circulars/a076/a76s.html>. The supplemental handbook has been revised three times: in 1983, 1996, and 1999. It was superseded by the 2003 version of Circular A-76

<sup>13</sup> *The Freedom From Government Competition Act (S. 1724): Hearing Before the Senate Committee on Governmental Affairs*, 104<sup>th</sup> Cong. (Sept. 24, 1996) (testimony of John A. Koskines, Deputy Director for Management, Office of Management and Budget).

<sup>14</sup> Stephen Barr, *More Than 100,000 Jobs Expected to ace Outsourcing Review*, The Wash. Post, Oct. 6, 2003, at B2.

<sup>15</sup> General Accounting Office, Report to Congressional Requesters, *Competitive Sourcing Greater Emphasis Needed on Increasing Efficiency and Improving Performance*, Rep. No. GAO-04-377 (Feb. 2004), available at <http://www.gao.gov>.

<sup>16</sup> *Id.*

In October 2000, as a result of controversy over competitive sourcing, Congress directed the Comptroller General to convene a panel of experts to study the government's competitive sourcing process under Circular A-76.<sup>17</sup> This panel of experts, called the Commercial Activities Panel, undertook a yearlong study. In April 2002, the Commercial Activities Panel reported their findings and set out ten sourcing principles, which have served as a frame for many of the 2003 revisions to Circular A-76.<sup>18</sup>

In August 2001, President George W. Bush's Administration announced its intent to open commercial activities performed by the government to competitive sourcing.<sup>19</sup> Soon thereafter, the President's Management Agenda designated competitive sourcing as one of five major initiatives.<sup>20</sup> This designation reflected a commitment to market-based government, where competition drives improved performance and efficiency. On May 29, 2003, the Bush Administration released the revised OMB Circular No. A-76, *Performance of Commercial Activities*.<sup>21</sup> The old supplemental handbook was rescinded, its contents were revised, and it was

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<sup>17</sup> Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001, Section 832, Pub. L. No. 106-398, (Oct. 30, 2000).

<sup>18</sup> Commercial Activities Panel, *Improving the Sourcing Decisions of the Government*, April 2002, available at <http://www.gao.gov/a76panel>.

<sup>19</sup> OMB Media Advisory, *OMB to Release President's Management Reform Agenda; Conduct Media Briefing*, August 24, 2001, available at <http://www.whitehouse.gov/omb/pubpress/2001-30>.

<sup>20</sup> The President's Management Agenda, Fiscal Year 2002, available at <http://www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf>.

<sup>21</sup> OMB Circular No. A-76, *supra* note 2. The revised Circular A-76 supersedes Circular No. A-76 (Revised 1999), August 4, 1983; Circular No. A-76 Revised Supplemental Handbook (Revised 2000), March 1996; Office of Federal Procurement Policy Letter 92-1, *Inherently Governmental Functions*, September 23, 1992; and OMB Transmittal Memoranda 1 through 25, Performance of Commercial Activities.

incorporated in the attachments to the revised circular in order to streamline guidance on public-private competitions.

#### B. *The Competitive Sourcing Process Under Circular A-76*

Competitive sourcing is the act of exposing government activities to competition with the private sector. Competitive sourcing is not the same as outsourcing. Outsourcing means that the activity is contracted out to the private sector.<sup>22</sup> Whereas, competitive sourcing is neutral regarding which source satisfies the government's need. Competitive sourcing is focused on the most effective and efficient way of accomplishing the agency's mission, whether it is done by civil servants or contractors.<sup>23</sup>

Circular A-76 provides detailed guidance on competitive sourcing.<sup>24</sup> It emphasizes six phases: preparing an inventory, preliminary planning, announcing and conducting the competition, conducting the competition using either a streamlined or standard competition process, implementing the performance decision, and conducting post-competition accountability activities.<sup>25</sup> The Federal Acquisition Regulation ("FAR") Subpart 7.3 contains a summary of Circular A-76's policy. Under Circular A-76 and the FAR, the private sector is to provide

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<sup>22</sup> David M. Walker, *The Future of Competitive Sourcing*, 33 Pub. Cont. L.J. 299 (2004).

<sup>23</sup> *Competitive Sourcing: Hearing Before the House Committee on Government Reform*, (June 26, 2003) (testimony of Angelia Styles, Administrator Office of Federal Procurement Policy), available at <http://competitivesourcing.nasa.gov>.

<sup>24</sup> Circular A-76 applies to executive departments, independent establishments, and military departments. Executive departments are named in 5 U.S.C. § 101. Independent establishments are defined in 5 U.S.C. § 104. Military departments are named in 5 U.S.C. § 102.

<sup>25</sup> OMB Circular No. A-76, May 29, 2003, *supra* note 2.

commercial activities. However, activities that are inherently governmental must be performed by government personnel.<sup>26</sup>

The first step in competitive sourcing is to identify all activities performed by government personnel as either commercial or inherently governmental.<sup>27</sup> All inherently governmental activities are excluded from competition as these activities must be performed by government personnel. The agency then determines whether each commercial activity is appropriate for private sector performance.

Agencies must appoint a competitive sourcing official (“CSO”) who is responsible for implementing competitive sourcing.<sup>28</sup> Oversight responsibility is centralized to facilitate fairness in streamlined and standard competitions and promote trust in the process. Each agency uses reason codes A though F to indicate the rationale for government performance of a commercial activity.<sup>29</sup> Reason code A is used as rationale to exempt commercial activities performed by

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<sup>26</sup> FAR 7.310.

<sup>27</sup> OMB Circular No. A-76, *supra* note 2.

<sup>28</sup> *Id.*

<sup>29</sup> OMB Circular No. A-76, Figure A2, sets out the reason codes. OMB may issue annual supplemental procedures for the use of these codes. A list of reason codes is found in paragraph C of Attachment A to OMB Circular A-76, as revised. A list is also found at [http://www.whitehouse.gov/omb/procurement/fair/2003reason\\_codes](http://www.whitehouse.gov/omb/procurement/fair/2003reason_codes). The current list of reason codes is as follows:

<u>Reason Code</u>	<u>Definition</u>
A	The commercial activity is not appropriate for private sector performance pursuant to a written determination.
B	The commercial activity is suitable for a cost comparison or a direct conversion.
C	The commercial activity is the subject of an in-progress cost comparison

Footnotes continued on the next page.

government personnel from private sector performance. For reason code A designations, the CSO must provide sufficient written justification for their exemption from competition. These written justifications for reason code A are made available to the public upon request. The requirement to provide justifications can be seen as biased against classifying a function as inherently governmental because there is no corresponding justification required for classifying a function as a commercial activity.

An agency must also justify a determination that a commercial activity is not appropriate for competition.<sup>30</sup> Agencies are given considerable latitude to determine if a commercial activity is inappropriate for public-private competition. Agencies may take various factors into consideration to make this decision, such as preservation of core competencies, unavailability of

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or direct conversion.

- D      The commercial activity is performed by a Most Efficient Organization resulting from a cost comparison decision made within the past five years.
- E      The commercial activity is pending an agency approved restructuring decision.
- F      Performance of the commercial activity by government personnel is required due to a statutory prohibition against private sector performance.

REASON CODES AND DEFINITIONS FOR COMMERCIAL ACTIVITIES INVENTORY	
CODE	DEFINITION
A	The commercial activity is not appropriate for private sector performance pursuant to a written determination by the CSO
B	The commercial activity is suitable for a streamlined or standard competition
C	The commercial activity is the subject of an in progress streamlined or standard competition
D	The commercial activity is performed by government personnel as the result of a standard or streamlined competition (or a cost comparison, streamlined cost comparison, or direct conversion) within the past five years
E	The commercial activity is pending an agency approved restructuring decision (e.g., closure, realignment)
F	The commercial activity is performed by government personnel due to a statutory prohibition against private sector performance

Figure A2.

<sup>30</sup> OMB Circular No. A-76, *supra* note 2.

private sector expertise, or need for confidentiality in support of senior level decision making.<sup>31</sup>

No two agencies are alike, and individual agency determinations differ.

The CSO may deviate from the circular; however, the CSO must obtain OMB's prior written approval.<sup>32</sup> Therefore, as long as the CSO obtains OMB's permission, the CSO may exempt a commercial activity performed by government personnel from performance by the private sector. Agencies are encouraged to use the deviation procedure, as provided in Attachment A of the circular, to explore innovative alternatives to standard or streamlined competitions, including public-private partnerships, public-public partnerships, and high performing organizations.

Previously, OMB set numerical goals for competitive sourcing. In March 2001, OMB set a target for agencies to compete or directly convert at least five percent of their full-time equivalent ("FTE")<sup>33</sup> commercial positions by the end of fiscal year 2002.<sup>34</sup> They also set a long-term target to compete at least fifty percent of commercial FTEs.<sup>35</sup> In August 2001, OMB set an additional target for agencies to compete an additional ten percent of their FTE commercial positions by the end of fiscal year 2003.<sup>36</sup> In January 2003, Congress required

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<sup>31</sup> *Competitive Sourcing: Conducting Public-Private Competition in a Reasoned and Responsible Manner: Hearing Before the Senate Subcommittee*, 108<sup>th</sup> Cong. (Jul. 24, 2003) Office of Management and Budget.

<sup>32</sup> OMB Circular No. A-76, *supra* note 2.

<sup>33</sup> A full time equivalent is a measure of federal civilian employment. One FTE is equal to one work-year of 2,080 hours.

<sup>34</sup> GAO-04-377 *supra* note 15.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

competitive sourcing goals to be based on considered research and analysis because it was concerned about the arbitrary nature of these numerical FTE targets.<sup>37</sup>

OMB recognized that quotas were inappropriate. Therefore, in July 2003, OMB replaced them with agency-specific plans that reflect each agency's mission and workforce mix. In place of quotas, milestones are emphasized. OMB developed a traffic light approach, using the colors red, yellow, and green, for evaluating progress agencies made in implementing competitive sourcing.<sup>38</sup> In December 2003, OMB issued a memorandum with guidance on the development of green competition plans.<sup>39</sup> That guidance notes the need for a long-range vision, strategic action by agencies, and public-private competitions tailored to the particular agency. The success of the competition plans depends to a large degree on the first step in the process—determining which activities are appropriate for competitive sourcing.

### C. Preparing Inventories Under the FAIR Act and Circular A-76

The Federal Activities Inventory Reform Act of 1998 ("FAIR Act") directs federal agencies to prepare an annual inventory of all their commercial activities that are performed by federal employees.<sup>40</sup> This requirement became an official part of Circular

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<sup>37</sup> P.L. 108-7, division J, Section 647 (Feb. 20, 2003).

<sup>38</sup> GAO-04-377, *supra* note 15. A green rating means that the agency has completed ninety-five percent of streamlined competitions in ninety days.

<sup>39</sup> Development of "Green" Plans for Competitive Sourcing, Dec. 22, 2003, available at [http://www.whitehouse.gov/omb/procurement/comp\\_sourc\\_green\\_plans122203.pdf](http://www.whitehouse.gov/omb/procurement/comp_sourc_green_plans122203.pdf).

<sup>40</sup> Federal Activities Inventory Reform Act of 1998, Pub. L. No. 105-270, 112 Stat. 2382.

A-76 with its 2003 revisions.<sup>41</sup> The inventory process, as set out in Attachment A of Circular A-76, is basically the same as what the FAIR Act requires. However, the circular does include additional requirements. Circular A-76 requires agencies to prepare two annual inventories that categorize all activities performed by government personnel as either commercial or inherently governmental.<sup>42</sup> The FAIR Act does not require an inventory of inherently governmental activities.

By June 30 of each year, each agency submits to OMB an inventory of commercial activities performed by government personnel, an inventory of inherently governmental activities performed by government personnel, and an inventory summary report.<sup>43</sup> Inventories must include the number of full-time employees, or its equivalent, that are necessary for the performance of the activity by a federal government source. The summary report is used to identify aggregate data. The total of the two inventories must reasonably equate to the agency's authorized personnel requirements.

The Director of OMB reviews the inventories and consults with the head of each agency regarding the content.<sup>44</sup> There is no formal written guidance for reviewing FAIR Act data. The OMB review looks for deviations from the norm, such as one agency listing a position as

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<sup>41</sup> The FAIR Act applies to the same agencies as Circular A-76. It does not apply to the General Accounting Office, government corporations, nonappropriated fund instrumentalities, and certain depot-level maintenance and repair of the Department of Defense.

<sup>42</sup> OMB Circular No. A-76, *supra* note 2.

<sup>43</sup> OMB issues guidance for the format and data requirements of the annual inventories at its website ([www.omb.gov](http://www.omb.gov)).

<sup>44</sup> FAIR Act, *supra* note 40; OMB Circular No. A-76, *supra* note 2.

inherently governmental while others classify it as commercial.<sup>45</sup> After review and consultation, all three inventories are made available to Congress and the public unless the inventory information is classified or otherwise protected for national security reasons.<sup>46</sup>

An interested party who disagrees with the agency's initial judgment can challenge the classification of an activity as commercial.<sup>47</sup> An interested party may also challenge the reason codes agencies use to identify whether a commercial activity is suitable for performance by the private sector.<sup>48</sup> If not satisfied with this review, the interested party may demand a higher agency review on appeal.<sup>49</sup>

Challenges to an agency's classification of its activities promote transparency and accountability.<sup>50</sup> Permitting challenges enables private sector interest groups to see what

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<sup>45</sup> GAO-04-377, *supra* note 15.

<sup>46</sup> The Office of Federal Procurement Policy has published a FAIR Act User's Guide to help gain access to inventories through agency web-site addresses. This guide is available through OFPP's Internet site at <http://www.whitehouse.gov/OMB/procurement/fair-index>.

<sup>47</sup> FAIR Act, *supra* note 40. An interested party is a private sector source that is an actual or prospective offeror for any contract or other form of agreement to perform the activity; and whose direct economic interest in performing the activity would be adversely affected by a determination not to procure the performance of the activity from a private sector source. A representative of any business or professional association that includes in its membership such private sector sources is also considered to be an interested party. It extends to an officer or employee of an organization within an executive agency that is an actual or prospective offer to perform the activity. Finally, it includes the head of any labor organization, referred to in 5 U.S.C. § 7103(a)(4) that includes within its membership officers or employees of any such organization.

<sup>48</sup> OMB Circular No. A-76, *supra* note 2.

<sup>49</sup> FAIR Act, Section 3, *supra* note 40.

<sup>50</sup> Office of Management and Budget, *Reasoned and Responsible Public-Private Competition, Agency Activities Supplemental Report*, Sep. 2003; *Reasoned and Responsible Public-Private Competition, A Supplement to the July 2003 OMB Report Conducting Private Competition in a Reasoned and Responsible Manner*, Sept. 2003.

positions are considered to be inherently governmental and whether the reason codes are applied accurately. It also allows contractors to challenge an agency's determination that a commercial activity is too important or sensitive to outsource. It is important not to contract out an inherently governmental function. Therefore, it is important to provide for correction of erroneous decision to classify an inherently governmental function as commercial. However, an agency that wishes to insulate a particular activity from competition is able to at least significantly delay the process.<sup>51</sup> The FAIR Act does not provide for judicial review of an agency's final decision regarding an inventory classification. However, judicial review may be available under the Administrative Procedure Act.<sup>52</sup>

The development of accurate FAIR Act inventories is the foundation for determining which activities are appropriate for public-private competition. It is also a foundation for a successful competitive sourcing program. Circular A-76 is an aid to determine the best way to provide goods and services to the government to maximize value to taxpayers. However, for government to run more efficiently and effectively, agencies must not subject inappropriate activities to competitive sourcing. To do so would endanger an agency's ability to perform its core missions.

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<sup>51</sup> *An Update on the Bush Administration's Competitive Sourcing Initiative: Hearing Before the U.S. Senate Subcomm. On Oversight of Government Management, the Federal workforce and the District of Columbia*, 108<sup>th</sup> Congress (July 24, 2003) (Statement of Paul C. Light, the Paulette Goddard Professor of Public Service, New York university, and the Douglas Dillon Senior Fellow, Brookings Institution).

<sup>52</sup> Robert H. Shriver III, *No Seat at the Table: Flawed Contracting Out Process Unfairly Limits Front-Line Federal Employee Participation*, 30 Pub. Cont. L.J. 4, 613-641 (2001).

### III. DECIDING WHICH ACTIVITIES ARE APPROPRIATE FOR COMPETITIVE SOURCING

#### A. *Defining Inherently Governmental Functions*

Competitive sourcing strategy calls for agency specific competition plans that are customized based on considered research and sound analysis, to address each agency's mission and workforce mix. The first step to a customized competitive sourcing plan is to develop workforce inventories, as required by the FAIR Act and Circular A-76. Before an agency takes this first step, it must know what an inherently governmental function is and what a commercial activity is.

"Inherently governmental" was first formally defined in 1992 in Office of Federal Procurement Policy ("OFPP") Policy Letter 92-1.<sup>53</sup> An inherently governmental function is one that is so intimately related to the public interest as to mandate performance by government employees.<sup>54</sup> Such a function requires either the exercise of discretion in applying government authority or the making of value judgments in making decisions for the government. Inherently governmental functions normally fall into two categories: the act of governing and monetary transactions and entitlements. Inherently governmental functions do not include gathering information or providing advice or ideas to federal government officials. It excludes functions that are primarily ministerial and internal in nature, such as building security, mail operations, housekeeping, or other routine mechanical services. In contrast, a commercial activity is described as "a recurring service that could be performed by the private sector and is resourced,

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<sup>53</sup> OFPP Policy Letter 92-1, Sept. 23, 1992, *available at* <http://www.arnet.gov/Library/OFPP/PolicyLetters/Letters/PL92-1>.

<sup>54</sup> *Id.*

performed, and controlled by the agency through performance by government personnel, a contract, or a fee-for-service agreement.”<sup>55</sup> “A commercial activity is not so intimately related to the public interest as to mandate performance by government personnel.”<sup>56</sup>

Basically, an inherently governmental function is the interpretation and execution of the laws of the United States. OFPP Policy Letter 92-1 defined this as any action to:

Bind the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise;

Determine, protect, and advance its economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, contract management, or otherwise;

Significantly affect the life, liberty, or property of private persons;

Commission, appoint, direct, or control officers of employees of the United States; or

Exert ultimate control over the acquisition, use or disposition of the property, real or personal, tangible or intangible, of the United States, including the collection, control, or disbursement of appropriated and other Federal funds.<sup>57</sup>

OFPP is not the sole guidance for defining inherently governmental. The FAIR Act provides a statutory definition, which adopts OFPP’s inherently governmental definition. FAR Subpart 7.5, which implements OFPP Policy Letter 92-1, prescribes policies and procedures to ensure inherently governmental functions are not performed by contractors. It sets out examples

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<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

of inherently governmental functions and functions not considered to be inherently governmental.<sup>58</sup>

A universally accepted competitive sourcing principle is that inherently governmental and certain other functions should be performed by federal workers.<sup>59</sup>

Contrary to this principle, the 2003 revision of Circular A-76 increases the threshold for categorizing inherently governmental functions.<sup>60</sup> Although the circular states that it “shall not be construed to alter any law, executive order, rule, regulation, treaty, or international agreement,” it does narrow the definition of an inherently governmental function as set out in the FAIR Act of 1998.<sup>61</sup> The FAIR Act requires the exercise of *discretion* for a function to be deemed inherently governmental. However, Circular A-76 tightens this definition by emphasizing that a person must exercise *substantial discretion* in order to obtain inherently governmental status. This makes it harder to define jobs as inherently governmental. Circular A-76 also describes an inherently governmental

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<sup>58</sup> See Appendix A.

<sup>59</sup> Commercial Activities Panel, *supra* note 18.

<sup>60</sup> *The Bush Administration’s Wholesale Privatization Agenda: Hearing Before the Senate Subcommittee*, 108<sup>th</sup> Cong. (Jul. 24, 2003) (testimony of Bobby L. Harnage, Sr., National President of the American Federation of Government Employees, AFL-CIO).

<sup>61</sup> Circular A-76 provides additional guidance on what is considered to be inherently governmental. Inherently governmental activities normally fall into two categories: the exercise of sovereign government authority or the establishment of procedures and processes related to the oversight of monetary transactions or entitlements.<sup>61</sup> Such an activity binds the United States to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise. It may also involve determining, protecting, and advancing economic, political, territorial, property, or other interests by military or diplomatic action, civil or criminal judicial proceedings, or contract management. Inherently governmental activities may significantly affect the life, liberty, or property of private persons. Such activities may exert ultimate control over the acquisition, use, or disposition of United States property, including establishing policies or procedures for the collection, control, or disbursement of appropriated and other federal funds.

position as one that has discretion to commit the government to a course of action when two or more alternative courses of action exist and decision making is not already limited or guided. This is not a new definition, but when viewed in the context of the retreat from the presumption that activities are commercial in nature along with the tightened definition requiring substantial discretion, it is likely that the “discretion to commit” standard will be reviewed narrowly by OMB.<sup>62</sup>

There is controversy over Circular A-76’s tightened definition of inherently governmental. There is no longer a presumption that all activities are commercial in nature unless justified as inherently governmental. Deleting the presumption is a change in position from the original Bureau of the Budget Bulletin and its precedent of almost fifty years. The revised OMB Circular No. A-76 supersedes OFPP Policy Letter 92-1 and its definition of inherently governmental.<sup>63</sup> However, it does not replace the statutory authority of the FAIR Act. The National Treasury Employees Union (“NTEU”) believes that OMB has illegally trumped Congress in the revised definition. In 2003, NTEU filed a lawsuit in federal court alleging that OMB’s revisions to Circular A-76 are illegal. NTEU argues that the A-76 revisions require federal agencies to apply a substantially narrower definition of inherently governmental functions than is now contained in the FAIR Act.<sup>64</sup> Under the FAIR Act, functions involving collection,

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<sup>62</sup> Stephen M. Sorett, *Understanding the New A-76 Circular*, 38 Proc. Law. 1 (Summer 2003).

<sup>63</sup> OMB Circular No. A-76, *supra* note 2.

<sup>64</sup> *NTEU Views on the Administration’s Privatization initiatives: An Update on the Bush Administration’s Competitive Sourcing Initiative: Hearing Before the U.S. Senate Subcomm. On Oversight of Government Management, the Federal workforce and the District of Columbia*, Footnotes continued on the next page.

control or disbursement of federal funds are inherently governmental. However, under the revised Circular A-76, these functions are inherently governmental only if they include the authority to establish policies and procedures. This new definition will impact many federal employees. For example, the Internal Revenue Service's FAIR Act inventory of federal jobs available for privatization under this new definition will nearly double in 2004.<sup>65</sup> NTEU seeks to uphold the FAIR Act's definition of inherently governmental because ensuring that inherently governmental functions are performed by federal employees is firmly rooted in sound government policies.

Not every exercise of discretion is inherently governmental. To be inherently governmental, the use of discretion must commit the government to a course of action when two or more alternative courses of action exist and decision making is not already limited or guided.<sup>66</sup> For example, if a contractor develops options or implements a course of action with agency oversight, but is not authorized to decide on the course of action, this is not inherently governmental. Agencies must also consider if official discretion is limited. For example, the contractor may be so involved that agency management is not able to fully consider available options. Agencies must consider other factors to avoid transferring inherently governmental authority to contractors. For claims or entitlement adjudication services, agencies must consider the finality of the adjudicator's decisions and whether appellate review by an agency official is *de novo*. Also, agencies must consider if the adjudication services involve interpreting complex,

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108<sup>th</sup> Congress (July 24, 2003) (Statement of Colleen M. Kelley, National President of National Treasury Employees Union).

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

ambiguous legal authorities and the discretion to determine appropriate awards or penalties. Agencies must also consider whether a provider's authority to take action may significantly and directly affect life, liberty, or property.

The Commercial Activities Panel concedes it is difficult to define inherently governmental. There is no bright line between activities that are commercial and those that are inherently governmental. The two terms cannot be examined separately. An agency must ask whether an activity is commercial or inherently governmental simultaneously.<sup>67</sup> The answer is rarely definitive, however. The context of the function must also be considered. For example, doing laundry for the Navy is a commercial activity in the United States, but it can be an inherently governmental function on foreign soil in a war zone.<sup>68</sup> Setting the boundaries for competitive sourcing involves more than just context. It also involves strategic planning.

The identification of activities appropriate for competitive sourcing should be meaningful to an agency, without trying to develop bright lines between commercial and inherently governmental. There is no question there are some activities that government needs to perform. Federal employees need to perform certain warfighting, judicial, enforcement, regulatory, and policymaking functions.<sup>69</sup> The government needs to retain in-house capabilities even in functions that are performed by the private sector. The government needs acquisition skills to

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<sup>67</sup> *An Update on the Bush Administration's Competitive Sourcing Initiative: Hearing Before the U.S. Senate Subcomm. On Oversight of Government Management, the Federal Workforce and the District of Columbia*, 108<sup>th</sup> Congress (July 24, 2003) (Statement of Paul C. Light, the Paulette Goddard Professor of Public Service, New York University, and the Douglas Dillon Senior Fellow, Brookings Institution).

<sup>68</sup> *Id.*

<sup>69</sup> Commercial Activities Panel, *supra* note 18.

manage costs, quality, and performance. The government also needs to retain core competencies to help ensure effective mission execution, such as those directly linked to national security. Identifying an activity as commercial does not automatically mean the activity is appropriate for competitive sourcing. There are risks involved in subjecting an activity to competitive sourcing. These risks need to be analyzed and balanced to determine which activities are appropriate for competition.

#### *B. How Agencies Make Competitive Sourcing Decisions*

There are approximately 1,609,000 federal employees.<sup>70</sup> 751,000 positions are categorized as inherently governmental.<sup>71</sup> Of the 858,000 federal employees performing commercial activities, 442,000 have been categorized as not being available for competition.<sup>72</sup> 416,000, or 26 percent of total employees, are available for competition.<sup>73</sup> In arriving at these figures, federal agencies have used various approaches. Rarely does an agency decide on whether an activity is appropriate for competition based solely on whether the activity is inherently governmental. The real issue is what commercial activities in our free enterprise system the private sector should perform. The government has an obligation to perform inherently governmental functions. However, it may not be appropriate that every other function be performed by the private sector.

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<sup>70</sup> *Competitive Sourcing: Conducting Public-Private Competition in a Reasoned and Responsible Manner*, *supra* note 31. This figure is based on the OMB estimated aggregate workforce profile of agencies being tracked under the Presidential Management Agenda.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

Some government agencies developed a strategic approach to identify and prioritize activities for competition. They did this by integrating their strategic and human capital plans with their competitive sourcing plans. This goes beyond what Circular A-76 requires. Instead of just identifying positions for competition, they employ a broader assessment of FAIR Act inventories and a more comprehensive analysis of factors such as mission impact, potential savings, risks, current level of efficiency, market conditions, and current and projected workforce profiles. This approach provides less uniformity in the inventory stage of the process. However, it results in increased risk avoidance, efficiency, and customer satisfaction.

The Health and Human Services' component of the National Institutes of Health uses a steering committee of senior-level officials to determine which activities are appropriate for competitive sourcing.<sup>74</sup> The committee uses a systematic approach in making its decisions. Managers, who are familiar with the commercial activity under study, are given a set of evaluation questions. The questions assess a function regarding the agency's mission, human capital, and risk. The managers' answers are recorded and scored by a computer software application. The committee reviews the scores, considering factors such as the activity's impact on the mission, costs, socioeconomic impacts, and potential advantages to competitively sourcing the activity. Once a decision is made to competitively source an activity, agency officials then consider whether to re-engineer the applicable business process, whether to retain the activity in-house or to subject it to a public-private competition. This process considers the long term impact of competitive sourcing on the agency's core mission. This approach, however, may be too cumbersome for agencies with large, diverse components, such as the military services.

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<sup>74</sup> GAO-04-377 *supra* note 15.

The Department of the Treasury's component of the Internal Revenue Service uses business case analysis to determine whether to competitively source an activity.<sup>75</sup> The analysis, which is completed in approximately four to six months, calculates the economic benefits of competitively sourcing the commercial function. Agency officials consider whether the function is core to the mission, if there is potential to reduce cost and improve productivity, and how the function fits into the agency's planned strategic projects. The business case approach is beneficial because top-level management and leadership consider major decision variables such as economics, market research, and risk.

In June 2002, the Department of Education launched a management reform initiative, known as the One-Ed concept.<sup>76</sup> One-Ed uses an integrated approach to transform departmental operations. This concept considers all the elements of major departmental operations. It seeks management changes through integrated human capital reform, competitive sourcing and organizational restructuring. In developing its FAIR Act inventory, the Department of Education first analyzes its key processes. It then uses the results of this process to restructure positions as either commercial or inherently governmental. It then frames a broader analysis of the function's activities. This approach is beneficial to agencies seeking reorganization. However, it is not a beneficial approach for most agencies.

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<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

### C. DoD's Strategic Sourcing Program and Core Competency Approach

In the 1980's, private sector businesses radically changed their acquisition process. They moved from a tactical method of outsourcing to a strategic approach.<sup>77</sup> For the private sector, outsourcing began as a way to address limited resources or a desire to reduce headcount. It evolved into a tool to provide non-core functions so the corporation could focus its resources on its vision. Progressive firms moved from short-term transactions towards strategic relationships, where price alone was not the driving force for sourcing decisions. A decade later, DoD followed suit. Its acquisition process has become strategic.

In 1999, DoD introduced its Strategic Sourcing Program.<sup>78</sup> DoD's Strategic Sourcing Program provides a broader approach than the Circular A-76 process by "extending the opportunities to achieve efficiencies to areas that are exempt from the A-76 competitive processes."<sup>79</sup> It combines a strong competitive sourcing program with a comprehensive strategic approach as management tools for greater in-depth review of specific functions and activities.

The goal of the Strategic Sourcing Program is to determine whether processes can be eliminated, improved, or streamlined.<sup>80</sup> It focuses on an overall cost-efficiency strategy by function areas, rather than FTE positions. The process begins by focusing on core mission

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<sup>77</sup> Mark E. Nissen, Keith F. Snider, and David V. Lamm, *Managing Radical Change in Acquisition*, *Acquisition Review Quarterly*, Spring 1998.

<sup>78</sup> 2001 Defense Report Initiative Transition Report, *Better Business Practices for the Business of Defense*.

<sup>79</sup> Memorandum from the Under Secretary of Defense, to the Secretaries of the Military Departments, Apr. 3, 2003, Attachment 1, DoD Interim Guidance, *Strategic Sourcing Program*, Feb. 29, 2000, available at <http://web.lmi.org/osd/HOT/InterimGuidanceStrategicSourcing.pdf>.

<sup>80</sup> Memorandum from the Under Secretary of Defense, *supra* note 91.

competencies and service requirements. Every function or organization is assessed, regardless of whether it is commercial, commercial exempt from competition, or inherently governmental. Competitive sourcing is not the only option. A range of other options are available: consolidation, restructuring or reengineering, privatization, the adoption of better business management practice, the development of joint ventures with the private sector, asset sales, the possible devolution of activities to state and local governments and the termination of obsolete services or programs. This approach cuts across all functions, and components examine all of their operations rather than focusing only on the small segment of commercial activities. Strategic sourcing addresses whether a function should be performed at all before determining who should perform it. This first step is skipped in the Circular A-76 process.

An instrumental principle of DoD's Strategic Sourcing Program is that components must ensure that contracting out does not threaten their crucial core missions. Consistent with this principle, DoD is currently pursuing a core competency approach in making its sourcing decisions.<sup>81</sup> This approach is adopted from corporate management principles. A corporation needs a strategic approach to build core competencies. In order to survive, a corporation must consolidate its technologies and production skills into competencies that empower its individual businesses to adapt quickly to changing opportunities.

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<sup>81</sup> General Accounting Office, *DoD Faces Challenges Implementing Its Core Competency Approach and A-76 Competitions*, Report to the Ranking Minority Member, Subcomm. On Military Readiness, Comm. On Armed Services, House of Rep., Rep. No. GAO-03-818 (July 2003) available at <http://www.gao.gov>.

A core competency is associated with the private sector. However, seventy percent of DoD's personnel and material resources are involved in business-like functions.<sup>82</sup> Therefore, DoD can benefit by using private-sector business practices. A corporation should view itself as a portfolio of competencies, not as a collection of discrete businesses.<sup>83</sup> Wise managers, deciding whether to make or buy, start with end products and look upstream to the efficiencies of the supply chain and downstream toward customers.<sup>84</sup> Management's role is to articulate the corporation's strategic structure and build competencies.

At least three tests can be used to identify core competencies.<sup>85</sup> One, a core competence provides potential access to a wide variety of markets. For example, competence in display systems can lead to production of calculators, miniature TVs, and monitors for laptops. Two, a core competence should make a significant contribution to customer benefits of the end product. Three, a core competence should be difficult for competitors to imitate. Once a core competence is identified, management needs to identify the projects and people closely connected to it. This identifies core competencies as corporate resources not to be reallocated. Core competencies should not be outsourced without extensive deliberation. Once a core competency is outsourced, it is very difficult to bring it back to be performed within the corporation.

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<sup>82</sup> Warren M. Anderson, John J. McGuiness and John S. Spicer, *From Chaos to Clarity: How Current Cost-Based Strategies are Undermining the Department of Defense*, Report of the Military Research Fellows, DSMC 2000-2001 (Sept. 2001).

<sup>83</sup> C.K. Prahalad and Gary Hamel, *The Core Competence of the Corporation*, 68 Harvard Bus. Rev. 79 (May-Jun 1990).

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

Identifying core competencies is a critical step in long-term strategic planning. However, it is not the ultimate guide in determining which activities are appropriate for competitive sourcing. Agencies also need to identify the risks of competitive sourcing a particular commercial activity.

#### D. *The Army's Core Competency and Risk Assessment Approach*

The Army uses a core, non-core concept for assessing functions.<sup>86</sup> Initially, the Army focused on whether a function was core or non-core to its mission in classifying positions in its FAIR Act inventory. However, the Army discovered that this sole distinction was not a good basis for a competitive sourcing decision.<sup>87</sup> Designating a function as a core competency does not necessarily mean that in-house employees should perform the function, and it does not necessarily preclude competitive sourcing of the function. Other factors, such as risk and operational considerations, also must be considered. In addition, focusing on a position does not consider how well the function is being performed or who should perform it. By looking at broader functional areas, such as utilities and family housing, as opposed to positions, the Army is better able to identify potential positions for competition. For example, childcare and equal employment opportunity operations are not inherently governmental functions. They are also not core to the Army's mission. However, they are exempt from competition because they are important for military morale and quality of life.<sup>88</sup>

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<sup>86</sup> *Id.*

<sup>87</sup> GAO-04-377, *supra* note 15.

<sup>88</sup> *Id.*

At first, the Army assumed that all commercial positions were non-core to its mission and thus potential candidates for performance by the private sector or other government agencies.<sup>89</sup> However, in many instances, these non-core functions required additional analysis to determine the potential risks of the function being performed by the private sector. According to the Army, there are four categories of risk analysis: force management, operation, future challenges, and institutional.<sup>90</sup> Force management risk includes the ability to recruit, retain, train, and equip sufficient numbers of quality personnel and sustain the readiness of the force while accomplishing its operations tasks. Operational risk is the ability to achieve military objectives in a near-term conflict or other contingency. Future challenges risk involves the ability to invent in new capabilities and develop new operational concepts needed to dissuade or defeat mid- to long-term military challenges. Institutional risk is the ability to develop management practices and controls that use resources efficiently and promote the effective operation of the defense establishment.

Using a core competency approach and a risk assessment analysis allow more flexibility in competitive sourcing decisions than using an inherently governmental distinction alone. An example is the classification of the Army's medical activities. Many medical functions are not inherently governmental but are core to the Army's mission in some circumstances. Medical functions do not typically require unique military knowledge or skills, but medical activities in theater need to be performed by in-house personnel because contracting for medical support in host nations could present significant risk to United States personnel. Therefore, the Army has

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<sup>89</sup> *Id.*

<sup>90</sup> *Id.*

determined that the in-theater medical function is a critical element of its ability to accomplish its core competencies. Other medical functions are a mix of both core and non-core. Optical fabrication, which is the ability to produce replacement spectacles and protective gas mask inserts, is considered a core competency in support of operation forces close to the point of need in the area of engagement.<sup>91</sup> The same function performed in the United States is non-core. The Army has determined that its casualty and mortuary affairs function is non-core and is a commercial activity. However, national policy dictates that Army officials notify families of a casualty in-person. Although there may be less uniformity in FAIR Act inventories by using this strategic approach, it promotes increased efficiency.

Components are allowed to request exemption from the non-core designation. Such a request has to present a compelling case that a non-core designation could pose substantial and specific risks to core warfighting missions or would violate a statutory requirement affecting a function.<sup>92</sup> To evaluate requests for exemption, the Army supplemented the Senior Executive Council's definition of core competency. The Army provided six competencies identified by its Army Field Manual and other documents:

Shape the security environment—provide a military presence.

Prompt response—provide a broad range of land power options to shape the security environment and respond to natural or manmade crises worldwide.

Forcible entry operations—provide access to contested areas worldwide.

Mobilize the Army—provide the means to confront unforeseen challenges and ensure America's security.

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<sup>91</sup> *Id.*

<sup>92</sup> GAO-03-818, *supra* note 81.

Sustained land dominance—provide capabilities to control land and people across various types of conflicts.

Support civil authorities—provide support to civil authorities in domestic and international contingencies, including homeland security.<sup>93</sup>

The General Accounting Office was asked to assess DoD's progress in assessing its core competencies as a basis for sourcing decisions. They found that progress in assessing core competencies is varied and limited across defense components.<sup>94</sup> This is due to the multiple and ambiguous definitions of a core competency. They also found that the guidance to define a core competency is broad and subjective.<sup>95</sup> The General Accounting Office recommends that the Secretary of Defense, through the Senior Executive Council, clarify its expectations for sourcing decisions based on core competency assessment results.<sup>96</sup> The General Accounting Office also recommends that the Secretary of Defense provide additional guidance identifying the range of additional factors to consider once the determination is made that a function is not a core competency.<sup>97</sup>

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<sup>93</sup>*Id.*

<sup>94</sup>*Id.*

<sup>95</sup>*Id.*

<sup>96</sup>*Id.*

<sup>97</sup>*Id.*

## IV. EXEMPTING ONLY INHERENTLY GOVERNMENTAL FUNCTIONS FROM COMPETITION IS INADEQUATE

### *A. Inherently Governmental and Core Competency Are Not Interchangeable*

Core competency has different meanings depending on the context in which it is used. The term inherently governmental has been equated to the term core competency. The concepts are similar and overlap, but they are not always interchangeable. A core competency is not always inherently governmental, and vice versa. For example, wetlands regulation and eminent domain authority performed by the Army Corps of Engineers are inherently governmental, but they are not core to the Army's mission.<sup>98</sup> Conversely, certain medical services are not inherently governmental, but they are core to the Army's mission.<sup>99</sup>

DoD has used the term core competency to designate military and civilian essential positions required for military and national security reasons. The OMB supplemental handbook to Circular A-76 defined a core capability as "a commercial activity operated by a cadre of highly skilled employees, in a specialized technical or scientific development area to ensure that a minimum capability is maintained."<sup>100</sup> A core competency has also been associated with legislative requirements to establish core logistics capabilities within government-owned and government-operated facilities, including the equipment, personnel, and technical competence required to maintain weapon systems identified as necessary for national defense emergencies

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<sup>98</sup> GAO-03-818, *supra* note 81.

<sup>99</sup> *Id.*

<sup>100</sup> Circular No. A-76 Revised Supplemental Handbook, *supra* note 12.

and contingencies.<sup>101</sup> Regardless of which meaning is used, the determination of a core competency is subjective.

For DoD, the test of a core competency is whether it is directly necessary for warfighting.<sup>102</sup> DoD's Senior Executive Council<sup>103</sup> endorsed the core competency approach as one of its business transformation initiatives. It believes DoD "should focus its energies and talents on those functions that are core or directly linked to its warfighting mission, and which must be performed by the agency, with the expectation that necessary products or services associated with non-core functions should be obtained from other government agencies or the private sector."<sup>104</sup>

The Senior Executive Council used the concept outlined in a 1990 Harvard Business Review article to explain the concept of core competency.<sup>105</sup> Applying the business tree concept to the military services, core services are the set of activities that actually contribute to the value

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<sup>101</sup> GAO-03-818, *supra* note 81.

<sup>102</sup> U.S. Department of Defense, *Quadrennial Defense Review Report*, Sept. 30, 2001.

<sup>103</sup> The Senior Executive Council is a high-level management committee established in 2001 to (1) help guide efforts across the department to transform and improve the department's business practices, and (2) to function as a board of directors for DoD. This Council is chaired by the Secretary of Defense and is comprised of the Deputy Secretary of Defense, the service secretaries, and the Under Secretary of Defense for Acquisition, Technology and Logistics. (taken from footnote 15, General Accounting Office, *DoD Faces Challenges Implementing Its Core Competency Approach and A-76 Competitions*, Report to the Ranking Minority Member, Subcomm. On Military Readiness, Comm. On Armed Services, House of Rep., Rep. No. GAO-03-818, *supra* note 81).

<sup>104</sup> GAO-03-818, *supra* note 81.

<sup>105</sup> C.K. Prahalad and Gary Hamel, *supra* note 83, at. 79-92.

of the end product, that is, land, sea, and air operations.<sup>106</sup> The leading business of DoD is to provide a trained and ready force. The business units are the units of a component command. The end products are military effects. The customer is the combatant commander employing forces and resources. The Council provided several definitions of core competency and gave criteria in its April 2002 implementing memorandum. A core competency in a defense environment is a “complex harmonization of individual technologies and ‘production’ (employment, delivery) skills that create unique military capabilities valued by the force employing” [commander-in-chief].”<sup>107</sup> The Council provided the following definitions as guidance:

Proficiency in the coordination of human activity and employment of technology and technical systems to conduct military operations called for by a [commander-in-chief].

A complex integration of human knowledge and skills with the technologies of warfare to accomplish a military objective of value to a commander.

It’s what we do better than anyone else to produce specific effects desired by a [commander-in-chief].

The essence of what we provide in world-class warfighting and related unique capabilities—through a synergistic combination of knowledge, technologies, and people—to produce desired effects for [commanders-in-chief].

The deep commitment of people, using technologies and delivering capabilities to meet a desired effect in support of national objectives.

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<sup>106</sup> *Id.* A corporation is like a tree. Its trunk and major limbs are core products. The smaller branches are business units. Leaves, flowers, and fruits are end products. The root system, which provides sustenance and stability, is the core competence.

<sup>107</sup> GAO-03-818, *supra* note 81.

A synergistic employment of individual and organizational knowledge, technologies, and capabilities producing world-class services (military operations) to deliver a desired effect to a [commander-in-chief].<sup>108</sup>

There are three themes common to each of these definitions: the knowledge and experience acquired by people, the discrete and finite set of technologies the people employ, and the business objectives to be achieved.<sup>109</sup>

The Senior Executive Council also provided criteria for determining core competencies.

A core competency:

Has potential application to a wide variety of national security needs,  
Provides a significant contribution to the combatant commander's desired effect,

Would be difficult for competitors to imitate,

Provides the means to differentiate from competitors,

Crosses organizational boundaries within an enterprise,

Is a direct contributor to the perceived value of the service,

Does not diminish with use,

Deploys with forces, and

Provides training and experience that forms the basis of ethos and culture.<sup>110</sup>

These criteria are based on business concepts, and they may or may not help to identify core capabilities of government agencies.

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<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

## B. *The Inherently Governmental Distinction Does Not Address Risks*

Distinguishing between inherently governmental and commercial activities is not adequate or realistic.<sup>111</sup> It is appropriate to hire civilian contractors to provide commercial activities that do not need to be performed by federal employees. For example, it makes sense for the private sector to perform maintain military aircraft maintenance and feed troops. However, there is an increased reliance on civilian contractors on the battlefield.<sup>112</sup> There is no longer a bright line dividing the two functions. Rather, it is more like edges around a cloud, and contractors are gradually fading further into the cloud.<sup>113</sup> The work that soldiers and contractors do is often interchangeable.<sup>114</sup> The issue government agencies face is how far into the cloud should the contractors be allowed to go.

There are examples where deciding whether to competitively source an activity based on whether it is an inherently governmental function does not make sense. For example, contracting out should not threaten crucial core missions. Commercial activities can be contracted out to such an extensive extent that it undermines the government's ability to perform its mission. Important work should not be sold off to contractors whose only motivation is increased profit margins, not the safeguarding of our lands. In addition, agencies must maintain enough in-house

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<sup>111</sup> Steven L. Schooner, *Competitive Sourcing Policy: More Sail than Rudder?*, 33 Pub. Cont. L.J. 263 (2004).

<sup>112</sup> See Rebecca R. Vernon, *Battlefield Contractors: Facing the Tough Issues*, 33 Pub. Cont. L.J. 369 (Winter 2004).

<sup>113</sup> Ariana Eunjung Cha & Renae Merle, *Line Increasingly Blurred Between Soldiers and Civilian Contractors*, Wash. Post, May 13, 2004, at A16, (quoting Retired Maj. Gen. Edward B. Atkinson, the former deputy chief of staff of intelligence of the Army's European operations).

<sup>114</sup> *Id.*

control to maintain the technical capacity to know when and if contractors are doing their job. A government agency's acquisition staff needs to analyze business problems and develop acquisition strategies.<sup>115</sup> For example, human capital, and job and market analysis are required to inventory agency activities. Current and projected workforce profiles should also be considered. Agencies need to consider the bigger picture, not just individual activities, so that the government's ability to perform core competencies is not eroded. This requires taking a strategic approach in classifying activities in the FAIR Act inventory.

There are risks associated with outsourcing activities that are currently being performed by federal employees. There are human capital risks. One risk is a decrease in employee morale. A decrease in employee morale is one result of competitive sourcing. It is difficult to convince employees that the competitive sourcing program is designed to create value and improve efficiency, and not to reduce the federal workforce. Another risk is outsourcing an activity when there are insufficient human resources for oversight of the contractor. There are fewer personnel with expertise in government procurement.<sup>116</sup> President Bill Clinton's reinventing government program shrunk the federal workforce by more than 400,000 civilian jobs, mostly at the expense of DoD civilian jobs at the end of the Cold War.<sup>117</sup> To implement competitive sourcing, additional federal employees may be required. For example, the Army

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<sup>115</sup> GAO-04-377, *supra* note 15.

<sup>116</sup> *DoD Competitive Sourcing: Lessons Learned System Could Enhance A-76 Study Process* (GAO/NSIAD 99-152, July 21, 1999).

<sup>117</sup> Martin Kady II, *Congress Builds a Barrier to Bush Privatization Plan*, CQ Weekly, Oct. 11, 2003, at p. 2486.

will require approximately 100-150 additional personnel, including attorneys, human resource specialists, and contracting officials, to implement revised Circular A-76.<sup>118</sup>

There are operational risks in contracting out some functions. The distinction between contractors and the military has become too blurry, and the military has become too dependent on contractors it cannot properly control.<sup>119</sup> Contractors have long served alongside soldiers in wars. In the past, contractors provided mainly mundane duties, such as cooking, supporting technology systems, and transporting supplies. In recent years, contractors have been entrusted with more sensitive functions, such as providing technical trainers, security protection details, linguistics experts, prison interrogators, and intelligence services. The increased reliance on contractors saves money, provides skills the military lacks, and allows the military to concentrate on its core mission of protecting the country. However, the expanded role of contractors also involves risks. Field commanders have no direct control over contractors or contractor employees, and this poses a risk of contractor accountability and continuation of essential services.<sup>120</sup> A contractor's duty is to its shareholders, not to its military customers.<sup>121</sup> A fear is that contractors will flee en masse when under extreme duress, exposing U.S. soldiers to catastrophic risk. This actually happened. Sixty South Korean subcontractors, working for the

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<sup>118</sup> GAO-04-377, *supra* note 15.

<sup>119</sup> Ariana Eunjung Cha & Renae Merle, *supra* note 113.

<sup>120</sup> See Rebecca R. Vernon, *Battlefield Contractors: Facing the Tough Issues*, *supra* note 112.

<sup>121</sup> Anthony Bianco and Stephanie Anderson Forest, *Online Extra: A Talk with Halliburton's Generals*, Business Week Online, Sept. 15, 2003.

Washington Group International, Inc., left Iraq a week after two of their colleagues were killed in an ambush.<sup>122</sup>

The plan to convert military jobs to civilian ones ignores the importance of jobs that can be an escape valve for overstretched soldiers. “The home-based military jobs are not simply ones that can or must be done by military, but they provide the balance in the system that allows rotation of operating people, whether they be aboard a ship or in an occupied country, to afford them some rest and time with their families between deployments.”<sup>123</sup> An all-volunteer force cannot meet its recruiting goals without sensible balance. “Continuing to treat our military—either real or perceived— as pawns to do nothing but war, patrol or occupation, while civilians occupy safe and restful posts, often at higher pay and convenient hours, is not may idea of effective leadership.”<sup>124</sup>

Postwar Iraq is the extreme result of outsourcing.<sup>125</sup> “Perhaps the reality of fighting the war in Iraq and having to depend on so many unreliable contractors for logistics has sobered up officials who in the past seemed virtually intoxicated by thought of an almost wholly privatized Defense Department.”<sup>126</sup> Soldiers and civilian contractors have become virtually

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<sup>122</sup> Ariana Eunjung Cha, *After Attach, s. Korean Engineers Quit Iraq*, Wash. Post, Dec. 8, 2003, at A1.

<sup>123</sup> Stephen Barr, *Pentagon Starts Revising Personnel System, With Aim of Shifting Military Jobs to Civil Service*, Wash. Post, Jan. 5, 2004, at B2 (quoting James Colvard, who was the deputy director of OPM during the Reagan administration).

<sup>124</sup> *Id.*

<sup>125</sup> Ariana Eunjung Cha & Renae Merle, *supra* note 113.

<sup>126</sup> Christopher Lee, *Army Outsourcing Put on Hold*, Wash. Post, Jan. 5, 2004, at A15 (quoting John Gage, President of American Federation of Government Employees, the largest federal employee union).

indistinguishable and interchangeable. Civilian contractors are rebuilding Iraq's infrastructure, providing security details for occupation personnel, interrogating Iraqi detainees, and supplying the military with support personnel who handle diverse duties such as repairing tanks and cooking. Contract interpreters also advise military officials about the Iraqi culture, and it is not unusual for the contractors to sit in on high-level strategy meetings at the battalion or brigade level, or even to help plan convoy routes and raids. Civilian contractors amount to more than ten percent of United States personnel in Iraq.<sup>127</sup> Contractors have been at the center of controversies. Four security contractors were killed in April 2004 while escorting a United States military convoy.<sup>128</sup> This led to concerns about the lack of rules and regulations governing the private armies. In May 2004, there were allegations that contractors allowed or instructed soldiers to abuse detainees at a prison in Iraq.<sup>129</sup> This led to concerns about accountability. This is the result of outsourcing that ignores the fact that there are some things only government should do.

There are financial risks involved in competitive sourcing. Shifting government positions to contractor personnel requires funding.<sup>130</sup> The positions are not eliminated; therefore, new account funds will have to pay for the additional contractors needed to perform the functions currently being performed by government personnel. The Air Force alone has estimated an

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<sup>127</sup> Ariana Eunjung Cha & Renae Merle, *supra* note 113.

<sup>128</sup> *Id.*

<sup>129</sup> *Id.*

<sup>130</sup> GAO-03-818, *supra* note 81.

additional cost of \$5 billion over the next five years to shift military personnel away from commercial type functions to those more directly related to warfighting.<sup>131</sup>

There is inconsistency in classifying positions as either inherently governmental or commercial. An activity may be classified as both commercial and inherently governmental, depending on where it is performed. For example, the Army determined many activities, such as making eyeglasses for troops located in a war zone, are core to its mission even though not classified as inherently government when performed in the United States.<sup>132</sup> There should be consistency in the classification of positions as commercial or inherently governmental when positions contain a mix of commercial and inherently governmental tasks. However, a one-size-fits-all A-76 process should not be the norm.<sup>133</sup>

Accountability is a principle of competitive sourcing.<sup>134</sup> Accountability assures that the sourcing process is efficient and effective. Accountability requires defined objectives, methods to track success and deviations, and enforcement mechanisms. An established set of rules ensures that an agency's sourcing decisions are based on uniform, transparent, and consistently applied criteria. There is no accountability for the performance of public functions and for the

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<sup>131</sup> *Id.*

<sup>132</sup> GAO-04-377, *supra* note 15.

<sup>133</sup> Warren M. Anderson, John J. McGuiness and John S. Spicer, *From chaos to Clarity: How Current cost-Based Strategies are undermining the Department of Defense*, Report of the Military Research Fellows, DSMC 2000-2001.

<sup>134</sup> Commercial Activities Panel, *supra* note 18.

use of public funds if management's primary functions are performed by contractors.<sup>135</sup>

Agencies need to balance the need for accountability and consistency while maintaining flexibility.

There are numerous imperfections in the Circular A-76 process, specifically the identification of activities for competitive sourcing by the inherently governmental and commercial activities distinction. There is no perfect solution. However, the process can be improved. Whether to competitively source an activity is a business decision and it requires strategic planning.

## V. RECOMMENDATIONS

The key to a successful competitive sourcing program is to identify what non-core activities are appropriate for private sector performance. The benefits of competitive sourcing are decreased costs, increased efficiency and improved performance. To maximize these benefits, agencies should use a strategic approach in determining which activities it will competitively source under Circular A-76. This process begins with a determination of which activities are inherently governmental and which activities are commercial. However, this distinction is not determinative of which activities are appropriate for competitive sourcing. Two additional steps are needed. Agencies should use a strategic approach to identify their core competencies. Then agencies should determine which non-core commercial activities are appropriate for competitive sourcing by conducting a risk assessment analysis.

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<sup>135</sup> *An Update on the Bush Administration's Competitive Sourcing Initiative: Hearing Before the U.S. Senate Subcomm. On Oversight of Government Management, the Federal workforce and the District of Columbia, supra note 57.*

The business of government does have similarities with private corporations and some basic corporate principles can be adopted to improve the government's procurement process. Private corporations use a strategic approach in deciding which activities to perform in-house and which activities to outsource. In deciding whether to outsource a function, many corporations ask the three following questions: how long could we preserve our competitiveness if we did not control this particular core competence; how central is this core competence to perceived customer benefits; and what future opportunities would be foreclosed if we were to lose this particular competence?<sup>136</sup> Government agencies can benefit by adopting such a strategic approach in making competitive sourcing decisions. Agencies need to consider the long term impact of competitive sourcing on an activity, such as if outsourcing the activity will affect the agency's core missions. A strategic approach will provide for long term planning. A strategic approach will also provide for the uniqueness of each agency.

Agency missions, organizational structures, and workforce composition vary widely. Differences between agencies are expected, because it is a reflection of their different missions, organizational structures, budgets, and programming policies.<sup>137</sup> Therefore, agencies must develop a tailored approach to its competitive sourcing decisions. Agencies must have flexibility in determining which functions and activities should be performed by government employees. This includes the flexibility to determine its core competencies.

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<sup>136</sup> C.K. Prahalad and Gary Hamel, *supra* note 83, at 79-92.

<sup>137</sup> Share A-76!, *Process Overview*, available at <http://www.emissary.acq.osd.mil/inst/share.nsf/CONTDEPL00K/About+A-76-Process+Overview>.

The government must ensure that it retains the ability to perform its core competencies. If core functions are outsourced, government may lose the ability to accomplish its missions. Therefore, agencies must not limit themselves to the inherently governmental distinction in exempting activities from competition. Agencies need to analyze their key missions and identify what activities are core to its accomplishment. They must then consider how the core competencies fit into the agency's planned projects. This process would resemble the private corporation's strategy of identifying core competencies by starting with its end product, looking upstream to efficiencies in the supply chain and downstream towards customers. The process should never cease, but should be continuous to identify changes in core competencies.

Core competencies may change over time. Government has been asked to provide different services over time. For example, the military departments are no longer just warfighters. They have taken on the role of peace keepers and peace makers. The military is also involved in rebuilding countries, such as Iraq in 2004. Demands made on military personnel can change dramatically over a short period of time, as evidenced by the results of the September 11, 2001 terrorist attacks. Because core competencies may evolve, agencies need flexibility in classifying their workforce inventories.

Utilizing a core competency approach, in addition to an inherently governmental and commercial activity distinction, is not adequate. A core competency approach allows flexibility in determining what activities should be competitively sourced. However, not every activity that is non-core is appropriate for private sector performance. In addition, there are some activities that are neither inherently governmental nor a core competency, but are inappropriate for performance by the private sector. More analysis is required. Using a risk analysis similar to that of the Army is a more strategic approach to competitive sourcing decisions. A risk analysis

takes into consideration any unique risks that are relevant to the activity. It is never a rigid process.

The FAIR Act inventory process is a very formal, rigid process. Private sector businesses use less formal and less restrictive methods. They utilize a make-or-buy process to decide what to outsource.<sup>138</sup> Core competencies are performed in-house. Private corporations employ an administrative benefit-cost analysis to determine which non-core activities to outsource. This process differs substantially from firm to firm. Private sector businesses take into consideration various costs, not just monetary costs. For example, they consider employee morale and attempt to design make-or-buy decisions that sustain employee morale relevant to business success.<sup>139</sup> The process used by private corporations is a risk assessment analysis.

There are potential risks of the government outsourcing an activity. The risks are unique to each agency and perhaps to each activity. Agencies need to identify these specific risks and weigh them against the benefits of subjecting a commercial activity to competitive sourcing. The result is a more strategic, effective competitive sourcing program.

A risk assessment analysis will factor human capital resources into the competitive sourcing equation. “You can never privatize the duty of loyalty to the greater good.”<sup>140</sup> In some activities, the risk of losing the loyalty of government employees will outweigh the benefit of competitive sourcing. Therefore, agency leadership must be committed to making human capital

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<sup>138</sup> *Competitive Sourcing: What the Data Actually Show Hearing Before the Subcommittee on Oversight of Government Management*, 108<sup>th</sup> Cong. (2003) (statement of Jacques S. Gansler, Professor, Univ. of MD).

<sup>139</sup> *Id.*

<sup>140</sup> David M. Walker, *supra* note 22.

a top priority. Competitive sourcing decisions should embrace the ability to attract and retain skilled employees. This is consistent with the principle announced by the Commercial Activities Panel that “federal sourcing policy should be consistent with human capital practices designed to attract, motivate, retain, and reward a high-performing federal workforce.”<sup>141</sup> Federal employees, whether civilian or military, are not just a commodity, to be traded in for contract personnel. Just as a corporation considers employee morale in its sourcing decisions, the federal government needs to do the same. Government agencies need to factor in recruitment and retention goals, job satisfaction, moral, and promotion potential. A risk assessment analysis considers employee morale. Morale may not be a core competency, but it is a risk associated with competitive sourcing. Morale is important in order to recruit and retain quality people. Therefore, risk analysis is a dynamic approach that factors in long-range strategic planning.

For DoD, a risk analysis will take into consideration the ability to retain military personnel. Retention, rather than recruiting and training, provides the best return on DoD’s investment in training and experience.<sup>142</sup> Defense Secretary Rumsfeld invoked emergency powers to authorize a temporary increase in the army by 30,000 troops, above its congressionally approved limit of 482,000.<sup>143</sup> This increase was to facilitate the restructuring of forces severely strained by operations in Iraq and Afghanistan. This action acknowledges that relief for deployed troops is needed. The U.S. military has come under great stress over the past two and

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<sup>141</sup> *Id.*

<sup>142</sup> Donald H. Rumsfeld, *2003 Secretary of Defense Annual Report to the President and the Congress*, available at <http://www.defenselink.mil/execsec/adr2003>.

<sup>143</sup> Bradley Graham, *30,000 More Soldiers Approved by Rumsfeld*, Wash. Post, Jan. 29, 2004, at A1.

one-half years, with the Army's troop rotation being the largest since World War II, with about 250,000 troops being rotated in and out of Iraq and Afghanistan.<sup>144</sup> Additionally, restructuring efforts hope to transfer approximately 10,000 noncombat jobs to civilians so that those soldiers are free for warfighting.<sup>145</sup> Such a move ignores reenlistment problems. The increased deployments during the wars in Iraq and Afghanistan have intensified the burdens traditionally borne by military families. The Washington Post, the Henry J. Kaiser Family Foundation and Harvard University conducted a poll of more than 1,000 spouses living on or near the ten heaviest-deploying Army bases. Seventy-six percent said they believe the Army is likely to encounter retention problems as a result of the post-September 11 pace.<sup>146</sup> Repeated and unpredictable deployments are Army spouses' biggest issue. The Army's internal data also indicate morale problems among troops serving in Iraq. Converting military positions to contract positions frees up the military so that it can focus on the military essential activity of warfighting. However, DoD needs to consider what the affect will be on retention. A good indicator of whether a military member will remain in the service is their commitment to the military lifestyle.<sup>147</sup> Therefore, maintaining quality of life is important to ensure DoD sustains a dedicated and experienced military workforce. If military members only perform warfighting functions, some quality of life is lost. Deployments will increase, resulting in increased time away from family. DoD's civilian workforce comprises approximately fifty percent of the total

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<sup>144</sup> *Id.*

<sup>145</sup> *Id.* (quote from Gen. Peter Schoomaker, Army Chief of Staff).

<sup>146</sup> Thomas E. Ricks, *Army Spouses Expect Reenlistment Problems*, Wash. Post, Mar. 28, 2004, at A1.

<sup>147</sup> Donald H. Rumsfeld, *supra* note 142.

government workforce.<sup>148</sup> DoD needs to encourage their best talent, both military and civilian, to stay. Job security is just one facet of that encouragement. Job satisfaction and moral is another. A risk assessment analysis will consider these important factors.

A risk assessment analysis would take into consideration all other relevant risks. For example, contractor performance may require additional administrative oversight. Performance by government employees may decrease productivity. A change in conditions may pose unacceptable risks, such as during war or mobilization. In a particular activity, the importance of high performance may shift to cost effectiveness. A risk assessment analysis is adaptable to changing circumstances and changing needs.

Identifying core competencies and utilizing a risk assessment analysis may result in less uniform classification of positions. However, the trade off is increased efficiency, risk avoidance, and customer satisfaction. Targeting only non-core commercial activities, in which the risks of competitive sourcing outweigh the risks of performance by government employees, will result in maximized value to taxpayers. It may not provide the cheapest source of a good or service, but it will provide the best source in the long term.

The General Accounting Office has concluded that DoD's core competency approach is too nebulous, because DoD does not provide concrete guidance. The guidance is general. However, this gives individual components the ability to adapt competitive sourcing decisions according to their needs. They should not have to adapt their needs around competitive sourcing programs. Lower level management should be empowered to make decisions, with the CSO's approval. This approach does not lessen transparency. It does not decrease fairness.

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<sup>148</sup> *Id.*

If the goal is to have positions labeled consistently throughout an agency, then there is inflexibility in the process. The decision whether to competitively source an activity is a business decision which requires flexibility. Just as outsourcing decisions vary between private corporations, agencies and even components within an agency, cannot be expected to make identical sourcing decisions. Individual components within an agency should be empowered to make the decision regarding which activities should be performed by the private sector, with oversight from the CSO. Inconsistencies within a component should be allowed, if they are adequately justified. There may be less consistency in this approach. However, there is more flexibility to make long-term strategic planning.

Agencies do need to provide clear guidance in terms of expectations. Each agency needs to clearly establish its goals of competitive sourcing. The goals should not be in terms of inflexible categorization of activities or numerical conversion of government positions. Rather, goals should be stated in terms of long-term strategic planning.

## VI. CONCLUSION

Competitive sourcing plays a key role in government operations. It can provide an efficient, effective procurement process and can result in cost savings to taxpayers. A critical step in the competitive sourcing process is to determine which activities should be performed by government employees and which activities are appropriate for competition. Using an inherently governmental and commercial activity distinction alone is not adequate. Thus, there must be more analysis.

By using a three step approach in determining which activities are appropriate for competitive sourcing, government agencies have more flexibility to make long-range strategic planning. The first step is to identify which functions are inherently governmental and which

functions are commercial activities. Inherently governmental functions are exempt from competitive sourcing. The second step is to identify the agency's core competencies. Core competencies may be inappropriate for competitive sourcing. The third step is to conduct a risk assessment to determine which commercial activities are appropriate for competitive sourcing. When an activity is performed by the private sector, there may be risks involved. There are also risks involved when the activity is performed by federal employees, rather than by the private sector. The identified risks are specific, not only to each agency, but also to each activity. When all the risks relating to a specific activity are identified, the agency weighs the risk of performing the activity in-house as compared to the risk of performing the activity by the private sector. The result of the analysis is a well informed business decision on whether the activity is appropriate for competitive sourcing.

## APPENDIX A

### *Examples of Inherently Governmental Functions*

#### **FAR 7.503 Policy:**

- (a) Contracts shall not be used for the performance of inherently governmental functions.
- (b) Agency decisions which determine whether a function is or is not an inherently governmental function may be reviewed and modified by appropriate Office of Management and Budget officials.
- (c) The following is a list of examples of functions considered to be inherently governmental functions or which shall be treated as such. This list is not all inclusive:
  - (1) The direct conduct of criminal investigations.
  - (2) The control of prosecutions and performance of adjudicatory functions other than those relating to arbitration or other methods of alternative dispute resolution.
  - (3) The command of military forces, especially the leadership of military personnel who are members of the combat, combat support, or combat service support role.
  - (4) The conduct of foreign relations and the determination of foreign policy.
  - (5) The determination of agency policy, such as determining the content and application of regulations, among other things.
  - (6) The determination of Federal program priorities for budget requests.
  - (7) The direction and control of Federal employees.
  - (8) The direction and control of intelligence and counter-intelligence operations.
  - (9) The selection or non-selection of individuals for Federal Government employment, including the interviewing of individuals for employment.
  - (10) The approval of position descriptions and performance standards for Federal employees.
  - (11) The determination of what Government property is to be disposed of and on what terms (although an agency may give contractors authority to dispose of property at prices within specified ranges and subject to other reasonable conditions deemed appropriate by the agency).
  - (12) In Federal procurement activities with respect to prime contracts-

- (i) Determining what supplies or services are to be acquired by the Government (although an agency may give contractors authority to acquire supplies at prices within specified ranges and subject to other reasonable conditions deemed appropriate by the agency);
  - (ii) Participating as a voting member on any source selection boards;
  - (iii) Approving any contractual documents, to include documents defining requirements, incentive plans, and evaluation criteria;
  - (iv) Awarding contracts;
  - (v) Administering contracts (including ordering changes in contract performance or contract quantities, taking action based on evaluations of contractor performance, and accepting or rejecting contractor products or services);
  - (vi) Terminating contracts;
  - (vii) Determining whether contract costs are reasonable, allocable, and allowable; and
  - (viii) Participating as a voting member on performance evaluation boards.
- (13) The approval of agency responses to Freedom of Information Act requests (other than routine responses that, because of statute, regulation, or agency policy, do not require the exercise of judgment in determining whether documents are to be released or withheld), and the approval of agency responses to the administrative appeals of denials of Freedom of Information Act requests.
- (14) The conduct of administrative hearings to determine the eligibility of any person for a security clearance, or involving actions that affect matters of personal reputation or eligibility to participate in Government programs.
- (15) The approval of Federal licensing actions and inspections.
- (16) The determination of budget policy, guidance, and strategy.
- (17) The collection, control, and disbursement of fees, royalties, duties, fines, taxes, and other public funds, unless authorized by statute, such as 31 U.S.C. 952 (relating to private collection contractors) and 31 U.S.C. 3718 (relating to private attorney collection services), but not including-
- (i) Collection of fees, fines, penalties, costs, or other charges from visitors to or patrons of mess halls, post or base exchange concessions, national parks, and similar entities or activities, or from other persons, where the amount to be collected is easily calculated or predetermined and the funds collected can be easily controlled using standard case management techniques; and
  - (ii) Routine voucher and invoice examination.

(18) The control of the treasury accounts.

(19) The administration of public trusts.

(20) The drafting of Congressional testimony, responses to Congressional correspondence, or agency responses to audit reports from the Inspector General, the General Accounting Office, or other Federal audit entity.

(d) The following is a list of examples of functions generally not considered to be inherently governmental functions. However, certain services and actions that are not considered to be inherently governmental functions may approach being in that category because of the nature of the function, the manner in which the contractor performs the contract, or the manner in which the Government administers contractor performance. This list is not all inclusive:

(1) Services that involve or relate to budget preparation, including workload modeling, fact finding, efficiency studies, and should-cost analyses, etc.

(2) Services that involve or relate to reorganization and planning activities.

(3) Services that involve or relate to analyses, feasibility studies, and strategy options to be used by agency personnel in developing policy.

(4) Services that involve or relate to the development of regulations.

(5) Services that involve or relate to the evaluation of another contractor's performance.

(6) Services in support of acquisition planning.

(7) Contractors providing assistance in contract management (such as where the contractor might influence official evaluations of other contractors).

(8) Contractors providing technical evaluation of contract proposals.

(9) Contractors providing assistance in the development of statements of work.

(10) Contractors providing support in preparing responses to Freedom of Information Act requests.

(11) Contractors working in any situation that permits or might permit them to gain access to confidential business information and/or any other sensitive information (other than situations covered by the National Industrial Security Program described in 4.402(b)).

(12) Contractors providing information regarding agency policies or regulations, such as attending conferences on behalf of an agency, conducting community relations campaigns, or conducting agency training courses.

- (13) Contractors participating in any situation where it might be assumed that they are agency employees or representatives.
  - (14) Contractors participating as technical advisors to a source selection board or participating as voting or nonvoting members of a source evaluation board.
  - (15) Contractors serving as arbitrators or providing alternative methods of dispute resolution.
  - (16) Contractors constructing buildings or structures intended to be secure from electronic eavesdropping or other penetration by foreign governments.
  - (17) Contractors providing inspection services.
  - (18) Contractors providing legal advice and interpretations of regulations and statutes to Government officials.
  - (19) Contractors providing special non-law enforcement, security activities that do not directly involve criminal investigations, such as prisoner detention or transport and non-military national security details.
- (e) Agency implementation shall include procedures requiring the agency head or designated requirements official to provide the contracting officer, concurrent with transmittal of the statement of work (or any modification thereof), a written determination that none of the functions to be performed are inherently governmental. This assessment should place emphasis on the degree to which conditions and facts restrict the discretionary authority, decision-making responsibility, or accountability of Government officials using contractor services or work products. Disagreements regarding the determination will be resolved in accordance with agency procedures before issuance of a solicitation.

## APPENDIX B

### *Strategic Sourcing Program Decision Tree*

